A History of Banking in Antebellum America

Financial Markets and Economic Development in an Era of Nation-Building

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To Nadine, Elmetta, Fay, and Irene, who never let me doubt the importance of learning

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It is not possible to introduce into a single volume all that is curious or interesting about banks; and scarcely less difficult to avoid some things that may appear trifling or impertinent.

J. S. Gibbons, 1859

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1 Introduction: Historical Setting and Three Views of Banking

Credit, in some form or other, is the principal lever of business operations
New York Bank Commissioners (1831)

The banker, therefore, is not so much primarily a middleman in the commodity "purchasing power" as a producer of this commodity. . . . He stands between those who wish to form new combinations and the possessors of productive means. He is essentially a phenomenon of development. . . . He makes possible the carrying out of new combinations, authorises people, in the name of society as it were, to form them. He is the ephor of the exchange economy.
Joseph Schumpeter (1934)

SETTING THE STAGE

The hallmark, some may even argue – as many did during the era of Manifest Destiny – the birthright, of America is growth: growth in population, geography, economy. When Robert R. Livingston and James Monroe, under President Thomas Jefferson's direction, negotiated the purchase of the Louisiana Territory from Napoleon for the paltry sum of four cents per acre, the United States was, with a population of about five million souls, confined to a tiny strip of land bounded by the Atlantic to the east and the Appalachians to the west. It was a marginal nation – marginal militarily, politically, and economically – on the periphery of the Western world. But it was not to remain so. The Louisiana Purchase, which Jefferson believed would accommodate the next one hundred generations of Americans, nearly

doubled the nation's territorial expanse. The error of Jefferson's expectations soon became apparent, however. A birthrate half again as great as Europe's and unprecedented waves of immigration produced a population that grew by about 35 percent every decade, and one that rapidly peopled Jefferson's territorial legacy. Through a series of treaties and military conquests, the nation again nearly doubled in size between 1804 and 1850, a broad expanse also quickly peopled by a population that doubled between 1800 and 1820 and more than doubled again between 1820 and 1850.[1] On the eve of the Civil War, the United States was home to nearly thirty-two million people strewn across more than three million square miles.[2]

Within a half-century of the ratification of the Constitution the United States clearly underwent a remarkable transformation and became something more than an "insignificant nation on the European periphery."[3] Population increase and the opening to immigration of a vast new territory prompted wave upon wave of internal (and international) migration. In 1790 the geographic center of the American population lay in Kent County, Maryland some twenty-three miles *east* of Baltimore. By 1850 the center of the population had shifted to about twenty-three miles southeast of Parkersburg, Virginia (now West Virginia).[4] Over the subsequent decade the population continued its inexorable westward march and the geographic center crossed the Ohio River, establishing itself a few miles east of Chillicothe, Ohio.[5] Ohio, which itself had been an insignificant region on the periphery of the American economy in 1790, had by the Civil War become the third most populous state in the republic. By 1860 Illinois, Indiana, and Missouri, each inhabited mostly by native Americans and itinerant hunters and trappers in 1790, had more than one million souls.[6]

Accompanying these increases in population and geography was an equally, possibly more, impressive increase in economic output, both in the aggregate and per capita. Between 1840 and 1860 the population increased at a rate that implied a doubling every twenty-three

1. McPherson, *Battle Cry of Freedom*, pp. 6, 9.
2. Foner and Garraty, *Reader's Companion*, pp. 681–2.
3. McPherson, *Battle Cry of Freedom*, p. 9.
4. U.S. Department of Commerce, *Statistical Abstract*.
5. Norris, *R. G. Dun & Company*, pp. 4–5.
6. U.S. Census Bureau, *Population* (1870), p. 3.

years, yet real aggregate economic output expanded at a rate that implied a doubling every fifteen years.[7] To some economic historians, most notably Walt Whitman Rostow, such large and sustained increases in real per capita output signified that the United States had, sometime between 1840 and 1860, achieved "take-off" – that is, a "decisive interval in the history of a society when [economic growth] becomes its normal condition."[8]

For Rostow and others sympathetic to his interpretive framework, take-off results from three convergent influences: (1) a rapid rise in the rate of productive investment, (2) the development of one or more leading, technologically sophisticated industries, and (3) the "emergence of a political, social, and institutional framework which exploits the impulses to expansion in the modern sector . . . and gives growth an on-going character."[9] As appealing as Rostow's grand space-age metaphor may be, many remain skeptical and recent research into the pace and pattern of American economic growth suggests that few developed or developing countries experienced anything like true take-off. This was particularly true for the United States. Paul David, for example, by pulling together scattered scraps of evidence from a variety of sources and employing an ingenious estimating technique argued that there was little support for the notion that the U.S. economy experienced a Rostovian take-off in the 1840s or thereabouts. Instead, David's conjectural estimates point to an average annual increase in real per capita income between 1800 and 1835 of about 1.2 percent. Between 1835 and 1860, real per capita output grew by about 1.3 percent annually. David's conjectures imply a very slight acceleration, but suggest an economic transformation something less dramatic than a take-off.[10]

Utilizing data uncovered since David's conjectural estimates first appeared, Thomas Weiss recently revisited David's procedures, producing new conjectures concerning the pace of economic growth in the first half of the nineteenth century. Weiss's conjectures provide a somewhat different portrait of antebellum America. His estimates suggest a pattern of slightly accelerating economic growth. Between

7. Engerman and Gallman, "U.S. Economic Growth," p. 10; and U.S. Census Bureau, *Population* (1870), p. 3. The number of years required for a given series to double can be approximated by dividing 72 by the average annual growth rate of that series.
8. Rostow, *Stages of Economic Growth*, pp. 36, 38.
9. Ibid., p. 39.
10. David, "Growth of Real Product," pp. 155–7.

1800 and 1820, for example, real per capita output increased by about 0.4 percent per annum. Between 1820 and 1840, by 1.2 percent; and by 1.6 percent between 1840 and 1860.[11] Clearly, then, real economic activity was accelerating throughout the antebellum period, but that acceleration occurred prior to Rostow's dating. There is, in fact, little evidence of take-off per se, though the United States did experience a gradual upward trend in growth rates of economic output. Viewed from a longer-term perspective, noted Barry Poulson, "the transition to modern economic growth was not sharp and discontinuous, but rather covered a long period marked by episodes of economic growth and retardation."[12]

To date no general consensus has been reached concerning the nature and timing of economic growth and development in the antebellum economy.[13] Stanley Engerman and Robert Gallman, in their survey of the empirical literature, concluded that the decades encompassing 1807 to 1837 were, in fact, ones of economic growth and structural change (generally referred to as economic development).[14] During these decades, production was moving from the home and the artisan's shop to the factory. Real per capita output was expanding rapidly as was real per capita income. Though rising at rates that seem low by modern standards, the increases were impressive relative to the preceding half-century or so. While most might accept this characterization, debate begins when discussions about relative rates of growth and their timing arise. "Some scholars," as Engerman and Gallman noted, "would argue that acceleration was in evidence before the Civil War; others, only after it. But neither group would hold that acceleration was sudden; both see it as a fairly gradual process."[15] And this seems, for the time being, to be the best way of looking at things.

The issue yet to be resolved, and the one with which this book is chiefly concerned, is the role of banks and financial intermediaries in this "fairly gradual process." While mountains of work have been

11. Weiss, "Economic Growth before 1860," table 1.6, p. 24.
12. Poulson, "Economic History and Economic Development," p. 73.
13. The one exception to this statement might be a general antipathy toward Rostow's take-off schema. Though his notion of the process of growth and development has been largely abandoned, it remains as a monument (though often unrecognized as such) of the cliometric revolution. It was the provocative nature of his interpretation that spawned the search for answers that ultimately uncovered its shortcomings.
14. Engerman and Gallman, "U.S. Economic Growth," p. 17.
15. Ibid.

amassed considering the effects of increases in the traditionally defined, tripartite factors of production (land, labor, and capital – even technology), considerably less work has considered the role of financial intermediaries despite Douglass North's assertion that "capital formation in the nineteenth century is a story of successive improvements in financial mediation by organizations taking advantage of the opportunities created by the basic institutional framework."[16]

BANKS AND CAPITAL, REAL AND FINANCIAL

Prior to, or at least concurrent with, the onset of modern economic growth in most developed countries was an increase in the productive capital stock. While Kenneth Sokoloff has disputed the notion of capital deepening in early antebellum America, substantial capital accumulations were required to maintain even a given capital/labor ratio with an increasing share of the labor force engaged in manufacturing, however defined.[17] And estimates of the nineteenth-century American capital stock imply a pattern of economic development similar to that implied by research on real wages and per capita income. Gallman's research suggests that between 1800 and 1840 the domestic capital stock increased at an average annual rate of about 4 percent. Between 1840 and 1860, it increased at about 6 percent. To Gallman this was clear evidence of a "broad pattern . . . of an early [pre-Civil War] acceleration" in the pace of economic growth and the onset of modern development.[18]

Not only did increases in the capital stock, both in aggregate and per capita, suggest a quickening of economic growth in the mid- to late-antebellum years, but the changing composition of American capital also supports that conclusion. Like Sokoloff, Gallman noted that prior to 1840 the nature of capital investment changed very little, implying an expanded utilization of existing technologies. The period after 1840, however, witnessed a change in the nature of capital investment. The share of animals in the total dropped sharply, the

16. North, "Institutional Change in American Economic History," pp. 97–8.
17. Sokoloff, "Invention, Innovation, and Manufacturing," pp. 346, 358; Sokoloff, "Productivity Growth in Manufacturing," p. 681.
18. Gallman, "American Economic Growth before the Civil War," table 2.4, pp. 88–9.

share of structures increased modestly, but most notably the share of equipment rose markedly. The United States in the late antebellum era, wrote Gallman, was "an economy shifting in the direction of industrial activity and modern economic growth."[19]

Capital accumulation, like that occurring during the antebellum era, required increased rates of investment and savings. Lance Davis and Gallman's research suggest a general rise in the rate of capital formation in the early nineteenth century that predated the transition to modern economic growth, and that capital formation followed a pattern of long swings or Kuznets cycles similar to overall economic activity. The underlying cause of the increased rate of capital formation remains clouded, but Davis and Gallman suggested two possible explanations. One, that the investment function shifted in response to changes in aggregate demand.[20] The second, and the one they preferred, was that the savings function shifted out (relatively more, at least, than the investment function) largely as a result of increased savings rates among households. They offered four potential explanations of this shift in the savings function: (1) a simple change in consumer preferences toward future over present consumption; (2) an increase in per capita income with savings being income-elastic; (3) an increase in the returns to savings with savings being interest-elastic; and (4) a change in the composition of the group constituting the personal savings sector.[21]

Davis and Gallman focused on the last of these explanations and, in effect, argued that the apparently rapid rise in the savings rate was just that – more apparent than real, largely because savings took a different form in the latter half of the antebellum era. Farmers, they argued, tended to save more from current income than their urban counterparts, which would suggest that as labor migrated from agriculture to manufacturing in the nineteenth century the savings rate should have diminished. The noted rise in the savings rate was an increase in the *measured* savings rate not the actual savings rate. Early in the nineteenth century, before reasonably modern financial markets had penetrated the hinterlands, farmers had a single outlet for their savings – more labor and less leisure, particularly more labor invested in such nontraditional and unmeasured forms as land and

19. Ibid., p. 93.
20. Davis and Gallman, "Capital Formation," p. 25.
21. Ibid., pp. 48–9.

building improvements. Off-season labor became embodied physical farm capital. Once the financial sector extended its reach into the hinterlands, as it did after 1820 or so, financial instruments became an outlet for rural savings. No longer reliant only on capital improvements to their farms as a retirement fund, farmers faced a choice between physical and financial capital as alternative repositories for their savings.

Realizing this shift in the composition of capital required changed attitudes toward the exchange of physical for financial capital, and Davis and Gallman argued that this shift occurred in the nineteenth century. "Traditionally willing only to invest in assets he could touch," they wrote, "the saver . . . gradually became willing to hold scraps of paper representing real assets located far away in both space and experience."[22] Davis and Gallman believe these attitudes changed little by little, reaching full flower only in the postbellum era. The demands of Civil War finance followed by massive railroad and other corporate debt and equity issues in the postbellum era extended the scale and scope of financial markets and brought about the transformation. It seems likely, however, that the saver's willingness – even the rural saver's willingness – to hold these scraps of paper, symbolic capital as Davis and Gallman labeled it, arose considerably earlier. Banknotes were scraps of paper – symbolic capital – backed as they were by a simple corporate promise to deliver a physical asset at a future date, which from many people's point of view was something beyond the pale in both space and experience.

Not denying the importance of the fourth factor suggested by Davis and Gallman, their latter argument suggested that the third factor they identified – an increase in the returns to savings with savings being interest-elastic – was of equal importance. In the earliest stages of development financial saving was not nearly as sophisticated as it was to become. Savings, instead of taking form in the shape of corporate securities, government debt and the like, was embodied in money holdings. To the earliest American savers, the choice was not between a sophisticated, well-diversified mutual-fund and land improvements. It may have been, and most likely was, a choice between money holdings and additional physical assets. In 1800 banks and thus bank-supplied currencies were relatively

22. Ibid., p. 62.

unknown in the hinterlands. By 1820 banks had extended their reach and were monetizing at least some parts of the rural economy. And as banks became better known, more reputable, more established, and therefore more trusted, the return to holding real balances increased as a result of relatively low inflation rates, the increased ease of transacting with currency, and its increasing stability in expected value. Increases in the real return on money increased the demand for it and hence the equilibrium stock desired at any income level.[23] The economy experienced, to borrow Edward Shaw's terminology, monetary and financial deepening.

Both Shaw and Ronald McKinnon argued that money holdings and real capital accumulations were highly complementary in the early stages of economic development.[24] That is, conditions that made an increase in holding real cash balances attractive enhanced rather than inhibited private incentives to accumulate capital. The Shaw-McKinnon conclusion stands in sharp contrast to both the dominant Keynesian and monetarist models, which both hold that real cash balances substitute for capital accumulation. That is, both schools view money as a form of wealth that competed with other assets in wealth portfolios. But Shaw and McKinnon believed that such models were inappropriate vehicles for analyzing events in a developing country. Instead, the dominant paradigm was designed to highlight the implications of money holding on growth in a mature economy with well-functioning markets and a fiat currency issued by a monopoly central bank. Few, if any, of these prerequisites held in early nineteenth century America or most other developing countries. Eliminating, or even reversing these assumptions, leads to a world in which real cash balances were held because money was the only available financial instrument that could be freely bought and sold. Given this, if the

23. The return on money holdings need not be pecuniary. Money holdings were another form of asset accumulation (that is, they could be held as an alternative to physical assets, which tend to decay or depreciate depending on the exact form of the asset), which served as a store of value. In addition, money holdings decreased the costs of transacting – a benefit that could, theoretically at least, be measured and included in the real return to money holding. Modern monetary theory assumes that the real return on money is the negative of the inflation rate. This may be reasonable in an economy with a host of financial securities with a positive (nominal) return. Financial markets in developing countries, on the other hand, are not so sophisticated and money may be the only nonphysical asset widely available to small savers.
24. McKinnon, *Money and Capital*, pp. 43, 56–7 and chapter 5; Shaw, *Financial Deepening*, chapter 2.

desired level of investment increased for any given level of income, the average ratio of real cash balances-to-income would also increase. The emergence of banks and bank-supplied currency then directly affected the rate of capital accumulation. Bank-supplied currency performed its dual role as both a medium of exchange and a store of wealth. And as real cash balances were debt in that they represented liabilities generated in the intermediation process, money holding was not a distinct form of wealth, but was part and parcel of the process of capital accumulation.

A second crucial factor in the mobilization of capital – of drawing it from hoards and shifting from familial to impersonal lending – was the emergence of market-determined interest rates after about 1780. Winifred Rothenberg found that before the American Revolution debt documents rarely reported rates of interest. Interest, if it was charged at all (a debatable point according to Rothenberg) was reported simply as "lawful interest," or 6 percent in Massachusetts. Beginning in the 1780s, interest rates began rising sometimes as high as 9 percent, "floating free of their ancient and customary restraints."[25] Setting rates free of customary restraints allowed rates of return on financial instruments to compete with returns on physical capital, thereby making paper assets an attractive substitute for physical assets. This simple change was, as Rothenberg noted, "a phenomenon critical to the historical development of capital markets."[26]

To Shaw and other scholars who have studied the relationship between financial and economic development, the appearance of free-floating interest rates was necessary for a shift in economic momentum. Low effective interest rates, whether set by custom, law, or religious conviction, made bankers and money lenders "inert, content to service traditional borrowers and extract [their] monopoly profits from wide margins between low real loan rates and much lower real" returns on cash balances.[27] Freeing interest rates from their traditional limits, in combination with the development of a more competitive financial sector, encouraged lending to nontraditional borrowers whose projects may have been riskier than traditional enterprises, but were the ones most likely to encourage mercantile and industrial innovation and, hence, growth and development.

25. Rothenberg, "Emergence of a Capital Market," p. 790.
26. Ibid., p. 790.
27. Shaw, *Financial Deepening*, p. 123.

While the initial stirrings of financial modernity first appeared in the late eighteenth century, it was in the initial decades of the nineteenth century that they became broadly evident. Richard Sylla, Jack Wilson, and Charles Jones developed an impressive time series of financial returns on various financial instruments (corporate stocks, government bonds, and commercial paper) and suggested that "stock and bond data indicate that something like a financial watershed occurred around 1815."[28] The break was most evident in the stock market, where returns in the period 1815 to 1850 were substantially higher than in preceding decades. The 1815 to 1850 period, as well, demonstrated the least variability in stock returns in the 200 year period covered. It was, they noted, the longest and strongest bull market ever experienced in the United States. Although inferences drawn about general economic growth from admittedly small scraps of financial data should be taken with caution, they note that the "financial watershed that is evident around 1815 is consistent with other evidence that the pace of economic development quickened around that time."[29]

It was surely no coincidence that growth in the American commercial banking industry experienced one of its most fecund periods in the decades preceding and surrounding the great bull market. In 1790 there were only three chartered commercial banks in the United States. By 1815 there were 212; by 1835, 584; and that despite a war, an embargo, and a deep recession in the late 1810s and early 1820s. The question that naturally arises is: Which was the driving force? Did banks simply tag along on the coattails and capture the benefits of broader economic change? Or, did the arrival of banks predate – in some broad sense – the accelerating pace of economic growth occurring some time after 1820?

If the dating provided by David and Weiss's conjectures and those of Sylla, Wilson, and Jones are even approximately correct, there are two interpretations. One, and the one probably most appealing to most economic historians, is that the changes were largely concurrent, as concurrent, at least, as historical events approximately dated can be believed to be. The other, assuming that the dating of a financial watershed around 1815 is approximately correct and accepting that the 1820 to 1840 economic watershed occurred closer to 1840

28. Sylla, Wilson and Jones, "U.S. Financial Markets," p. 34.
29. Ibid., p. 40.